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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections	)	
of the Cable Television Consumer	)	MM Docket No. 93-215
Protection and Competition Act	)	
of 1992	)	
	)	
Rate Regulation	)	

COMMENTS OF UTAH LEAGUE OF CITIES AND TOWNS

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SUMMARY

The Utah League of Cities and Towns ("Utah League") supports the Commission's adoption of the benchmark and price cap approach as the primary means for regulating cable rates. Under the benchmark approach, cable subscribers will be assured of paying the lowest possible rates for cable service and the administrative burden on regulators and the Commission will be eased. For these reasons, cable operators should be encouraged to adopt the benchmark and price cap formulation for rates. However, in those extraordinary circumstances when the benchmark approach will prevent a cable operator from recovering its costs of providing service, cost-of-service rates could be justified.

The Utah League encourages the Commission to establish a detailed and rigorous regulatory framework for a cable operator's cost-of-service showing. The Commission should place limits on those cable operators choosing to make such showings. In this regard, the Commission should limit who can make cost-of-service showings to those cable operators whose unregulated rates were above the benchmark and who therefore had to lower the rates to the benchmark. The one exception to this limitation should be a cable operator who builds new infrastructure. In addition, the Commission should require cable operators to make their showings on Commission-prescribed forms and worksheets easing the administrative burden on regulators as much as possible.

The cost-of-service standards which the Commission develops should contain sufficiently detailed subcategories to ensure that a cable operator is required to justify its rates. The Utah League supports the Commission's proposed subcategories of annual expenses, ratebase and rate-of-return but advises the Commission to take a pro-active role in developing the required showings in each subcategory. The Utah League recognizes that a cable operator should be able to recover its cost-of-service to subscribers plus a reasonable profit. However, a cable operator should not use this cost-of-service showing to increase its profits through higher rates to subscribers. The Commission's regulatory framework should ensure that a cable operator does not so abuse the process. In addition, the Commission, as it formulates cost-of-service regulations, should reduce the burden on itself and other regulators as much as possible.

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COMMENTS REGARDING NOTICE OF PROPOSED RULE MAKING

Utah League of Cities and Towns ("Utah League"),[1] by its attorneys and pursuant to Section 1.415 of the Commission's Rules, hereby submits its comments regarding the Federal Communications Commission's Notice of Proposed Rule Making, ("NPRM"), FCC 93-353, released July 16, 1993, in the above-captioned proceeding. The NPRM was initiated to solicit comments on the Commission's proposals to establish a regulatory framework governing the cost-of-service showings by cable operators.

1. Regulatory Goals

In the Report and Order and Further Notice of Proposed Rule Making, FCC 93-177, 58 FR 29736 (May 21, 1993), ("Report and Order"), the Commission adopted a benchmark and price cap

1 The Utah League of Cities and Towns represents 229 cities and towns in the state of Utah which serve as the franchising authorities for cable systems operating in them.

approach for regulating rates of cable service based on rates charged by cable systems subject to effective competition. NPRM at ¶ 3. In the Commission's view the benchmark approach has substantial advantages over cost-of-service regulation because it protects consumers from excessive rates and "eliminate[s] the need for detailed cost-based regulation," keeping administrative costs low. Report and Order at ¶ 185. However, the Commission also recognized that the benchmark approach might not allow certain cable operators to recover the costs of providing regulated cable service to subscribers. NPRM at ¶ 5. Thus, the Commission is allowing cable operators to make cost-of-service showings to justify higher rates and is using this NPRM to establish a regulatory framework.

The Utah League supports the Commission's adoption of the benchmark and price cap approach as the primary means for regulating cable rates. The benchmark approach best serves the goals of Congress and the Commission and will ease the administrative burden on regulators and ensure that subscribers pay the lowest possible rates for cable service. Cable operators should be encouraged to adopt the benchmark and price cap formulation for rates rather than utilize a more burdensome cost-of-service formulation. As a practical matter, however, the Utah League acknowledges that cost-based rates are necessary in certain extraordinary situations and encourages the Commission to make it clear in the regulatory framework that the cost-of-service showing should only be made in certain extraordinary circumstances.

The Commission developed the benchmark formula by analyzing the rates of cable systems subject to effective competition. Report and Order at ¶ 186. The Commission proposes establishing a regulatory framework for cost-of-service rates that is also guided by the goal of producing rates that approximate competitive rate levels. NPRM at ¶ 10. The Utah League supports the establishment of cost-of-service rates that, as much as possible, approximate competitive rate levels. Such rates should, under the formulation established by the Commission, be based on the costs to the cable operator of providing services to its subscribers.

The Utah League also agrees with the Commission that cost-of-service rates should be tier-neutral just as benchmark rates are tier-neutral. NPRM at ¶ 11. Tier neutrality will discourage cable operators from moving programming from the basic tier to higher tiers because of varying standards for rates that the cable companies can charge to subscribers. In fact, by not making the cost-of-service formulation tier neutral, the Commission could be encouraging cable operators to move programming and therefore to charge more to its subscribers for service.

Any regulatory framework for justifying cost-based rates established by the Commission through this NPRM undoubtedly will increase the administrative burdens on the cable operator, and, more significantly, on regulators. While the Utah League joins the Commission in its concern over the increased burden on regulators and encourages the Commission to ease that burden whenever possible, it believes the Commission should be less concerned with the administrative burdens on cable operators. The cable operator is choosing the more burdensome formulation by raising its rates above the benchmark and charging cost-of-service rates, therefore its accompanying burden should be greater.

In general, the cable industry has experienced significant growth and success in recent years, thereby providing investors with excellent returns on investment. The proposed reduction in rates to the benchmark level will still provide cable operators a very healthy return on investment. In fact, use of the benchmark methodology will be better for the cable industry as a whole than widespread use of a cost-of-service formulation. In the Report and Order, the Commission recognized that "a benchmark could protect consumers from excessive rates, and, by eliminating the need for detailed cost-based regulation, would keep the costs of administration and costs would remain low". Id. at ¶185. Benchmark rates will encourage more efficient operation by cable operators, who will reap the full reward of any efficiencies introduced. In contrast, cost-of-service rates will provide no incentive for efficiency. In fact, unless cost-of-service showings are made burdensome on operators, cable companies could use cost-of-service regulation to increase the return on their investments through inefficiencies while charging consumers more for service.

2. Regulatory Requirements

In developing its regulatory framework for cost-of-service showings, the Utah League encourages the Commission to look at the examples provided by other regulated industries such as the telephone industry, the railroad industry, and gas pipeline industry to formulate a reasonable cost-based set of regulations for the cable industry. The Utah League recognizes the need to tailor the cost-of-service regulations to the cable industry but encourages the Commission to review the cost-based regulatory frameworks in these other industries as a guide to formulation of regulations for cable operators. In addition, a review of these other regulated industries may also enable the Commission to avoid the mistakes and failures encountered in earlier regulatory regimes.

A. Procedural Requirements for Cost-of-Service Showings

In establishing specific procedural requirements for cost-of-service showings, the Utah League encourages the Commission to make those requirements as strict as possible. However, the Utah League disagrees with the Commission's proposal to allow cable operators to make cost-of-service showings to either the local franchising authority or to the Commission on an annual basis. NPRM at ¶ 17. Allowing cable operators to make showings annually amounts to a repetitive filing. If, as the Commission states, it wants to limit the frequency of such showings, an annual showing is too frequent and too burdensome on regulators. Instead, the Utah League proposes that a cable operator be allowed to make a cost-of-service showing no more than once every three years. This would reduce the burden on the regulators who review the showings and prevent cable operators from frustrating the purposes of the Cable Television Competition and Consumer Protection Act of 1992, P.L. 102-385 (1992) ("1992 Cable Act").

The Utah League also believes that the Commission should restrict the class of cable operators eligible to proffer cost-of-service showings to justify higher rates. For example, any cable operator whose pre-regulation rates were not above the benchmark and which therefore did not need to lower them, should be automatically prohibited from making a cost-of-service showing. In the absence of effective competition, cable operators were setting rates at a profitable level prior to regulation. Thus, operators seeking to use the cost-of-service showing to increase their rates are merely attempting to illegally profit under the new regulations. The Utah League encourages the Commission to restrict cost-of-service showings to only those cable operators which had to lower their rates to the benchmark and are seeking only to restore the status quo ante.

There is one exception to this limitation -- a cable operator which has made a capital improvement to its system that will benefit subscribers or enhance service and necessitate an increase in rates to reimburse the operator for that capital improvement. For example, if a cable operator builds new infrastructure, then the Utah League believes that submission of a cost-of-service showing could be justified as long as the cable operator can make the detailed showings established under the Commission's regulations, tied to the new capital costs incurred.

The Utah League supports the Commission's proposal to require cable operators to make cost-of-service showings on a Commission-prescribed form and associated worksheet. NPRM at ¶ 19. The form and associated worksheets developed should require sufficiently detailed information from the cable operator to meet the regulatory requirements under a cost-of-service showing. The Utah League agrees that utilization of such a form would reduce administrative burdens and would ease the regulator's burden in analyzing the showings. NPRM at ¶ 19. As previously stated, the Utah League believes that the administrative burden on regulators should be reduced whenever possible.

B. Cost-of-Service Standards

The Commission proposes to apply a traditional formulation as the standard for cost-of-service showings. NPRM at ¶ 20. Under this formulation, cable company revenues should be equal to the expense of providing service plus a reasonable return on investment. NPRM at ¶ 20. The Utah League agrees with the Commission's proposed formulation but advises the Commission to develop sufficiently detailed subcategories (annual expenses, ratebase and rate-of-return) that a cable operator must be required to detail in order to charge higher-than-benchmark rates.

In this regard, the Utah League agrees with the Commission's tentative conclusion that the annual expenses subcategory should exclude "the expenses of providing services unrelated to the provision of cable service to subscribers." NPRM at ¶ 21. The Utah League also supports the Commission's prescribing depreciation rates for cable plants that accurately reflect the useful life of the plant. Id. Finally, the Utah League agrees that the Commission should use an original cost methodology to value a cable operator's ratebase and should exclude excess acquisition costs from the ratebase.

1. Annual Expenses

In the NPRM, the Commission proposes to permit the cable operators to recover operating expenses, depreciation and taxes as annual expenses. NPRM at ¶ 23. The Utah League agrees that a cost-based showing should include operating expenses, depreciation and some taxes as the annual expense of providing cable service. However, the costs allowed under each subcategory should be detailed and extensively supported.

a. Operating Expenses

The Utah League generally agrees with the operating expenses that the Commission proposes to include under a rate-based showing, including inclusion of programming expenses as recoverable operating expenses. NPRM at ¶ 24. However, programming expenses should not be a cost element for inclusion in the ratebase. If a cable operator builds a cable plant with certain channel capacity, the cable operator presumably intends to use all that capacity for providing service to its subscribers. The benchmark method allows a cable operator to increase its rates as it adds channels of programming. That is sufficient incentive for a cable operator to maximize use of its capacity.

The Utah League agrees with the Commission's proposal to exclude certain expenses from annual expenses, including lobbying expenses, membership fees and dues in social service and recreational or athletic clubs and organizations and penalties and fines paid for violations of statutes and rules. NPRM at ¶24. Recovery of the latter expense would be particularly egregious. A cable operator is forced to pay a penalty or fine as punishment for violating a statute or rule. The cable operator should not be able to subsequently profit from the violation by including the penalty or fine as an operating expense.

b. Depreciation

The Utah League agrees with the Commission's conclusion that it should prescribe depreciation rates for the regulated cable industry. NPRM at ¶ 27. Of the two potential depreciation rates proposed by the Commission, the Utah League favors the establishment of an industry-wide depreciation rate using the book value of an asset rather than the fair market value. The book value of an asset should be calculated on a straight line remaining life approach. In a cost-of-service showing, the depreciation rate should include individual rates for each plant category. Depreciation rates should not be linked to the circumstances of each franchise because it would allow for too much variation between cable operators and would place too large a burden on regulators.

The Utah League opposes the Commission's suggested alternative of temporarily monitoring the depreciation practices of cable operators rather than developing industry-wide depreciation rates. NPRM at ¶ 29. The risk of higher rates for cable subscribers and attempts by cable operators to recover excessive depreciation rates is too great to allow usage of this alternative. The potential reduction in administrative burdens is not worth the risk. Furthermore, with the information provided by cable operators and the industry, the Commission should be able to prescribe depreciation rates without significantly increased burden.

c. Taxes

The Utah League agrees with the Commission's proposal to allow some taxes incurred in the provision of regulated cable services to be recoverable as annual expenses. However, the Utah League opposes the inclusion of federal income taxes as annual expenses. Federal income taxes are paid by all citizens, both individuals and corporate. Cable companies should not be able to recover them as an annual expense of operations when other businesses cannot.[2] Moreover, if federal income taxes are

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2 The Utah League does not oppose recovery of state or local income taxes as annual expenses, because local taxes vary significantly from place to place and a

expensed, rates will be skewed depending upon an individual company's tax breaks, a result inconsistent with the public interest. The Utah League believes, however, that certain kinds of taxes can be included as annual expenses, such as real estate taxes and gross receipts taxes. These taxes rates vary significantly and are not dependent just on the level of income but may vary from region to region. Some cable operators may not even have to pay these types of taxes. No one operator should be penalized for the higher rate it pays in these areas.

2. Ratebase

The second subcategory under a cost-of-service showing is the ratebase which includes plant in service, plant held for future use and working capital. The Utah League agrees with the Commission's conclusion that these three categories should be included in the ratebase for the purpose of developing cost-based rates. NPRM at ¶ 31. The first category, plant in service, will, as the Commission states, probably be the largest portion of the ratebase. NPRM at ¶ 32. In order to determine the value of plant in service, the Commission proposes to adopt the used and useful and prudent investment standard as applied to the original construction cost of the assets being dedicated to service to subscribers. NPRM at ¶ 32. The Utah League agrees

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cable operator should not be penalized for providing service to a locality with particularly high local taxes.

with this standard for determining the value of the plant in service. Further, the Utah League believes that the appropriate value for plant-in-service is the original cost of the plant, including depreciation, retirements and improvements.

The other approaches being considered by the Commission are market value, replacement cost, and reproduction costs or any combination of these approaches. The Utah League does not believe these other approaches will provide the most accurate value of plant in service because each varies with the current market. Further, the Utah League believes that the Commission should use only one valuation method and that combining several methods would be too complicated and burdensome for both the regulators and the cable operators. The Utah League does believe, however, that an exception should be made for any plant that the cable operator refinances, if (and only if) the loan proceeds are used entirely in the cable operation, providing improved or additional service to subscribers. This exception should be limited to money that is invested back into the cable operation. If the refinancing is used by the cable operator as a way to pay dividends to investors, then the cable company should not be able to include the refinancing in the valuation of plant in service.

The Commission proposes to adopt two valuation methodologies, one for determining initial regulated rates under a cost-of-service showing and another for assessing proposed increases in rates of regulated cable service under a subsequent cost-of-service showing. NPRM at ¶ 33. The Utah League opposes this proposal and advises the Commission to adopt only one methodology which will simplify cost-based showings and administrative burdens. In addition, as pointed out by the Commission in the NPRM, an original cost methodology will produce the lowest rates for consumers and will also permit cable operators to fully recover the costs used to construct the plant used and useful in the provision of regulated cable service. Id. at ¶ 35.

The Utah League also believes that the Commission should, for the most part, disallow excess acquisition costs under the plant in service valuation methodology it chooses. Exceptions to this rule could include reasonable allocations for goodwill, customer lists and franchise rights, (collectively, "Goodwill"), which can legitimately be included in the rate base.

Alternatively, if excess acquisition costs (other than Goodwill) are included at all in the rate base, they should be amortized over a period of at least fifteen years. A cable operator should not be permitted to write off these excess acquisition costs immediately, but should amortize them over an appropriate period of time because these costs should provide value to the cable operation for that entire period and not just in the first year of operation. Amortizing these costs over a period of at least fifteen years will also produce the lowest possible subscriber rates.

The Utah League believes that the Commission should also apply the traditional rule of valuation to plant under construction. Under this rule, plant being constructed could not be included in the subscriber ratebase until the used and useful test is met, in other words, until the plant can be used for providing cable service. The Utah League believes this is the most fair method, because otherwise cable subscribers could end up paying for long-term construction costs and inevitable cost overruns without any benefit to their service. However, the Utah League believes that any interest paid during the construction period could be capitalized by cable operators during the construction period thereby providing the operator some benefit during the construction period.

The Utah League supports the Commission's intermediate approach to permitting the costs of excess capacity, cost overruns and premature abandonment to be depreciated or amortized but excluded from the ratebase. NPRM at ¶ 43. As stated in the NPRM, this would allow operators to recover costs over time, but would not allow any annual return on them. Id. at Footnote 47.

Finally, the Utah League supports the inclusion of working capital in the ratebase, but encourages the Commission to develop a more precise method of placing a value on working capital. The third alternative suggested by the Commission is most appropriate. NPRM at ¶ 45. Under this third approach, cable operators would conduct a lead/lag study to determine the amount of working capital included in the ratebase. Id. The advantage of this approach, as noted by the Commission, is that it will more closely reflect the amount of working capital contribution from investors necessary for operation of the business.

3. Rate-of-Return

The final subcategory included under the cost-of-service standards is the rate-of-return. Under this standard, the Commission proposes to permit cable operators to recover "a reasonable return on investment used and useful in providing regulated cable service." NPRM at ¶ 46. The Utah League agrees with the Commission's proposal to establish a single rate-of-return for provision of regulated cable service by all cable operators rather than attempting to establish a separate rate-of-return for each cable company or franchise area. Id. The Utah League believes the Commission should establish an "after tax" rate-of-return on investment of approximately 10%. ("After tax" should reflect only an adjustment for federal income taxes, since franchise fees and local income taxes are part of the rate base. See Part B(1)(c), supra.)

A 10% rate-of-return could meet both goals expressed by the Commission. It will keep subscriber rates low and still encourage a cable operator's reinvestment in infrastructure. NPRM at ¶ 47. The current rate-of-return on most investments is approximately 4-5%. Thus, allowing cable operators a 10% rate-of-return on investment after taxes would be double the current investment yield. This would encourage investment in cable operations because of the better return than in other types of industries but would not cause subscribers or service to suffer.

In order to establish a reasonable rate-of-return for the cable industry, the Commission is proposing to identify the rate-of-return for a comparable surrogate industry with the same approximate risk of economic loss. NPRM at ¶ 48. The Commission proposes to use Standard & Poor's 400 Industrials (S&P 400) as a surrogate. Instead, the Utah League believes that the Commission should use other regulated industries, such as the telephone industry, as a surrogate industry because it experiences the same approximate risk as cable operators. The regulated telephone companies are experiencing increased competition from competitive access providers, cellular telephone carriers and cable companies, just as cable companies are experiencing increased competition from Direct Broadcast Service ("DBS") and

Multichannel Microwave Distribution Service ("MMDS"). Thus, the Utah League believes that the regulated telephone companies will provide the best comparative surrogate for the cable companies.

The Utah League agrees with the Commission's tentative conclusion that the measurement of the cost of debt is largely a factual examination. NPRM at ¶ 53. The Utah League advises the Commission that when choosing a methodology for measuring a cable operator's cost of debt, preferred stock be excluded. In the valuation of a cable company, preferred stock should be considered equity rather than just debt. Cable companies get value from equity and should not be permitted to claim preferred stock as debt, thereby realizing a double value.

C. Cost Accounting and Cost Allocation Requirements

1. Cost Accounting Requirements

The Utah League agrees with the Commission's decision to require cable operators to maintain their accounts in accordance with Generally Accepted Accounting Principles (GAAP) and in a manner enabling identification of costs for cost-of-service showings. NPRM at ¶ 57. In this regard, the Utah League advocates adoption of the supplemental and financial cost accounting requirements in Appendix A to the NPRM. As previously discussed, the Utah League believes the cable operators should provide as much detailed information in a cost-of-service showing as possible without concern for the additional burden on the operator. To repeat, the operator is voluntarily choosing to make this showing rather than meet the benchmark rate. In addition, the Utah League also believes that the establishment of a more comprehensive system of accounting for cost-of-service showings, similar to the Uniform System of Accounts (USOA), as suggested by the Commission, is warranted. NPRM at ¶ 58. Aside from the advantages of facilitating both comparison of costs between firms and an analysis of the costs of individual firms as noted by the Commission, the USOA will provide a uniform accounting system for cable operators to follow. NPRM at ¶ 58. The "penalty" for failing to keep proper accounts should be loss of ability to depart from the benchmark.[3] The Commission should not be as concerned with the potential administrative burdens on cable companies. Under the benchmark and price caps approach, the extensive and detailed records necessary under a cost-of-service showing are not required. If a cable operator wants to reduce its administrative costs, it need only adhere to the benchmark rate. Cost-of-service rates should only be necessary in extraordinary circumstances, and not as a regular course of business.

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3 In that way, efficient cable operators satisfied with benchmark rates need not incur the administrative costs of a complex accounting system.

2. Cost Allocation Requirements

The Utah League supports the Commission's actions in 47 C.F.R. §§ 76.924(e), and encourages the Commission to set up strict guidelines so that regulated cable subscribers are not forced to subsidize the entrance of cable into other telecommunications industries such as telephone service and the Personal Communications Service ("PCS"). As the Commission stated in the NPRM, these activities do not necessarily enhance the provision of cable service to subscribers, and therefore cable subscribers should not be forced to pay for a cable operator's development of other forms of service.

D. Affiliate Transactions

The Commission should establish affiliate transaction rules which will regulate transactions between regulated and non-regulated portions of a cable system. In particular, the prices charged by vertically integrated programming suppliers should be subjected to strict scrutiny. Any general price rise by these suppliers raises the benchmark rates[4], and thereby shifts wealth from subscribers to programmers, so the incentives for less-than-arms'-length transactions are high. Additionally, alternative multi-channel programming distributors, such as wireless cable, must be able to obtain programming at a fair

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4 Report and Order at ¶ 251.

price if competition is to take root.[5] The Commission must be vigilant regarding cross-subsidies in general and programming cross-subsidies in particular.

The Utah League also agrees with the Commission's definition of an affiliated entity as an entity with a five percent (5%) or greater common ownership interest with the cable operator. NPRM at Footnote 67. The 5% standard proposed by the Commission is the same standard used in the cellular and other radio common carrier services under the Commission's Rules. See 47 C.F.R. § 22.13. The Utah League also believes it is the appropriate measure for cable television service.

The Utah League does not believe that the Commission should require cable operators to record affiliate transactions at prevailing company prices offered in the market place to third parties. NPRM at ¶ 68. It is not enough to look at the current or recent prices offered to third parties because, typically and historically, cable companies with monopolies in the market have been able to overcharge third parties for services and therefore this standard will not reflect the fair price for a service. Instead, the Utah League proposes that the Commission look at what non-cable affiliated programmers charge and historically obtained from cable companies and how much they had to pay. This

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5 Competition ultimately lowers the cable operator's administrative costs, because it exempts the cable operator from rate regulation.